DEPARTMENT OF STATE REVENUE

04-20100606.LOF

Letter of Findings: 04-20100606
Sales Tax
For the Years 2007, 2008, and 2009

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ISSUES

I. Sales Tax – Imposition.

Authority: IC § 6-2.5-2-1; IC § 6-8.1-5-1; IC § 6-8.1-5-4; IC § 6-8.1-9-1; 45 IAC 15-9-2; Lafayette Square Amoco, Inc. v. Indiana Dep't of State Revenue, 867 N.E.2d 289 (Ind. Tax Ct. 2007); Commissioner's Directive 13 (July 2007); Commissioner's Directive 13 (August 2010); Sales Tax Information Bulletin 2 (May 2002); Sales Tax Information Bulletin 2 (December 2006).

Taxpayer protests the imposition of sales tax on its sales of vehicles and optional/extended warranties.

II. Tax Administration – Negligence Penalty.

Authority: IC § 6-8.1-10-2.1; 45 IAC 15-11-2.

Taxpayer protests the imposition of the ten percent negligence penalty.

STATEMENT OF FACTS

Taxpayer is an Indiana dealer selling used cars. Pursuant to an audit, the Indiana Department of Revenue ("Department") determined that Taxpayer did not maintain adequate business records concerning the sales of vehicles. The auditor, thus, utilized records obtained from the Bureau of Motor Vehicles ("BMV"), which showed that Taxpayer sold and collected sales tax on certain sales of vehicles but Taxpayer did not remit the sales tax to the Department. Additionally, the Department's audit determined that Taxpayer sold extended/optional warranties to its customers but did not collect the sales tax.

Taxpayer timely protests the imposition of sales tax and negligence penalty. To support its protest, Taxpayer submitted pertinent documentation and directed the Department's attention to an itemized list. A hearing was held. This Letter of Findings ensues. Additional facts will be provided as necessary.

I. Sales Tax – Imposition.

DISCUSSION

The Department's audit assessed additional sales tax on vehicles which Taxpayer sold and collected sales tax per the BMV's records, but it failed to remit the sales tax to the Department. Taxpayer, to the contrary, claimed that it overpaid the sales tax. Taxpayer also asserted that the sales of the optional/extended warranties were not subject to sales tax and, therefore, it was not responsible to collect the sales tax.

As a threshold issue, all tax assessments are prima facie evidence that the Department's claim for the unpaid tax is valid; the taxpayer bears the burden of proving that any assessment is incorrect. IC § 6-8.1-5-1(c); Lafayette Square Amoco, Inc. v. Indiana Dept of State Revenue, 867 N.E.2d 289, 292 (Ind. Tax Ct. 2007).

IC § 6-2.5-2-1 provides:

> (a) An excise tax, known as the state gross retail tax, is imposed on retail transactions made in Indiana.
> (b) The person who acquires property in a retail transaction is liable for the tax on the transaction and, except as otherwise provided in this chapter, shall pay the **tax** to the retail merchant **as a separate added amount to the consideration in the transaction**. **The retail merchant shall collect the tax as agent for the state**. (**Emphasis added**).

A. Sales of Vehicles.

Pursuant to the audit, the auditor compared the BMV's records and Taxpayer's sales tax reports on its sales of the vehicles for tax years 2007-2009. The auditor found that Taxpayer sold and collected sales tax on certain sales of vehicles, but Taxpayer did not remit the sales tax to the Department. Thus, the Department's audit assessed additional sales tax. Taxpayer claimed that it was not responsible for the sales tax.

1. Sales of Twelve Vehicles during Tax Year 2007.

The audit assessed additional sales tax on twelve (12) vehicles which Taxpayer sold in 2007 because the BMV's record showed that Taxpayer collected the sales tax. Taxpayer, however, did not remit the sales tax on those vehicles to the Department.

Taxpayer stated that, for tax year 2007, it did not have the records of the vehicles at issue because it allowed an individual to use Taxpayer's "license for a retail deal at his home while he was working on the cars." Additionally, Taxpayer believed that it overpaid the sales tax for 2007. Taxpayer asserted that its overpayment is sufficient to offset the assessments. Thus, Taxpayer maintained that it was not responsible for the additional sales tax.

IC § 6-8.1-5-1(b), in pertinent part, states "[i]f the department reasonably believes that a person has not reported the proper amount of tax due, the department shall make a proposed assessment of the amount of the

unpaid tax on the basis of the best information available to the department. The amount of the assessment is considered a tax payment not made by the due date and is subject to IC § 6-8.1-10 concerning the imposition of penalties and interest."

IC § 6-8.1-5-4 further provides:

(a) Every person subject to a listed tax must keep books and records so that the department can determine the amount, if any, of the person's liability for that tax by reviewing those books and records. The records referred to in this subsection include all source documents necessary to determine the tax, including invoices, register tapes, receipts, and canceled checks.

(b) A person must retain the books and records described in subsection (a), and any state or federal tax return that the person has filed:

(1) For an unlimited period, if the person fails to file a return or receives notice from the department that the person has filed a suspected fraudulent return, or an unsigned or substantially blank return.

(2) In all other cases, for a period of at least three (3) years after the date the final payment of the particular tax liability was due, unless after an audit, the department consents to earlier destruction.

In addition, if the limitation on assessments provided in section 2 [IC 6-8.1-5-2] of this chapter is extended beyond three (3) years for a particular tax liability, the person must retain the books and records until the assessment period is over.

(c) A person must allow inspection of the books and records and returns by the department or its authorized agents at all reasonable times.

(d) A person must, on request by the department, furnish a copy of any federal returns that he has filed.

In this instance, Taxpayer stated that it allowed an individual using its license to sell vehicles "at his home while he was working on the cars." Because the license was issued to Taxpayer, Taxpayer thus is responsible for the consequences. Since Taxpayer did not maintain adequate records demonstrating the sales tax collected was remitted to the Department, Taxpayer is responsible for the sales tax.

Moreover, IC § 6-8.1-9-1(a) states:

If a person has paid more tax than the person determines is legally due for a particular taxable period, the person may file a claim for a refund with the department. Except as provided in subsections (f) and (g), in order to obtain the refund, the person must file the claim with the department within three (3) years after the latter of the following:

(1) The due date of the return.

(2) The date of payment.

For purposes of this section, the due date for a return filed for the state gross retail or use tax, the gasoline tax, the special fuel tax, the motor carrier fuel tax, the oil inspection fee, or the petroleum severance tax is the end of the calendar year which contains the taxable period for which the return is filed. **The claim must set forth the amount of the refund to which the person is entitled and the reasons that the person is entitled to the refund**. (**Emphasis added**).

45 IAC 15-9-2, in relevant part, illustrates:

(b) The department has no legal method of generating a claim for refund. A claim for refund can only be initiated pursuant to IC 6-8.1-9-1.

EXAMPLE

A taxpayer is audited by the department for the tax period 19X3. This audit results in an overpayment of tax. The department has no legal authority to automaticaly [sic] refund or credit this overpayment to the taxpayer. Instead, the taxpayer must file a claim for refund as prescribed in IC 6-8.1-9-1 and 45 IAC 15-9-1.

...

(d) When filing a claim for refund with the department the taxpayer's claim shall set forth:

(1) the amount of refund claimed;

(2) a sufficiently detailed explanation of the basis of the claim such that the department may determine its correctness;

(3) the tax period for which the overpayment is claimed; and

(4) the year and date the overpayment was made.

The claim for refund shall be filed on a form prescribed by the department. (**Emphasis added**).

The Department further explains the requirements to properly address a taxpayer's refund claim in the Commissioner's Directive 13 (July 2007), 20070801 Ind. Reg. 045070431NRA. Later, the Commissioner's Directive 13 (July 2007) was updated and the Commissioner's Directive 13 (August 2010), 20100728 Ind. Reg. 045100472NRA, in relevant part, states:

The claim for refund must be filed on a **Claim for Refund (Form GA-110L), an amended income tax return**, or a withholding tax return (Form WH-3) that **indicates an overpayment of tax**.

IC 6-8.1-9-1(a) also mandates that the claim must set forth the amount of the refund claimed and the reasons that the taxpayer is entitled to the refund. 45 IAC 15-9-2(d) provides that the claim for refund must set forth:

(1) **The amount of refund claimed;**

(2) A sufficiently detailed explanation of the claim so that the Department can determine its

correctness;

(3) The tax period for which the overpayment is claimed; and

(4) The year and date the overpayment was made.

Pursuant to IC 6-8.1-9-1(b), which requires the Department to consider the claim for refund, the Department, as part of its consideration of the claim, may request any additional information that might be necessary in making a determination regarding the validity of the claimed overpayment. (**Emphasis added**).

In this instance, Taxpayer claimed that it overpaid the sales tax of $4,900 and asserted that its overpayment could be used to offset the Department's assessment. Taxpayer did not file any GA-110L to claim a refund nor did Taxpayer provide sufficient documentation demonstrating that it was entitled to a refund. Thus, the Department is not able to agree that Taxpayer has met its burden of proof demonstrating the assessment is incorrect.

2. Sale of One Vehicle during Tax Year 2008.

The audit assessed additional sales tax on one (1) vehicle which Taxpayer sold and collected sales tax during tax year 2008, but it did not remit the sales tax to the Department. Taxpayer stated that it could not find the documentation.

As discussed in Part I. A. 1, Taxpayer must maintain adequate records so the Department can properly determine Taxpayer's tax liability. Additionally, the Department's proposed assessment is presumed to be correct and Taxpayer bears the burden to prove that the assessment is incorrect. Taxpayer did not keep adequate records, nor did Taxpayer provide documentation demonstrating that it had remitted the sales tax. Thus, the Department is not able to agree that Taxpayer has met its burden.

3. Sales of Three Vehicles which were Subsequently Repossessed.

The audit assessed sales tax on three (3) vehicles which Taxpayer sold in 2009 according to the BMV's records. Taxpayer stated, in relevant part, that:

These 3 cars were sold but due to the financing arrangements, they had to be titled before the bank would fund the contract. These are the only 3 deals all year the bank would not fund due to customer disqualifications after the fact of the delivery. The deals were backed out, the cars returned/repossessed and sales tax not paid because we made no sale.

However, Taxpayer did not provide documentation to substantiate its claim. Given the totality of the circumstances, in the absence of sufficient documentation, the Department is not able to agree that Taxpayer met its burden demonstrating that the assessment is incorrect.

4. Sale of a 2001 Honda CRV.

The audit assessed additional sales tax on Taxpayer's sale of a 2001 Honda CRV, which the audit summary listed the sale price as $1,900. Taxpayer claimed that the audit mistakenly assessed sales tax on the optional/extended warranty contract it sold on the 2001 Honda CRV. To support its protest, Taxpayer submitted a copy of its sales records. Taxpayer's documentation stated that it sold the 2001 Honda CRV for $10,100 which included "a 36/36 warranty and sales tax." Taxpayer's documentation also demonstrated that it did not separate the charges for the sale of optional/extended warranty, sales tax, and the sale price of the vehicle. Thus, the Department is not able to agree that Taxpayer has met its burden demonstrating that the Department's assessment is incorrect.

In short, Taxpayer did not provide sufficient documentation demonstrating that the assessment is incorrect.

B. Optional/Extended Warranties.

The Department's audit imposed sales tax on Taxpayer's sales of optional/extended warranty contracts. Taxpayer, to the contrary, asserted that it was not responsible for sales tax on its sales of the optional/extended warranties.

The prior version of Sales Tax Information Bulletin 2 stated as follows:

Optional warranties and maintenance agreements that contain the right to have property supplied in the event it is needed are not subject to sales tax. Any parts or tangible personal property supplied pursuant to this type of agreement are subject to use tax. Sales Tax Information Bulletin 2 (May 2002), 25 Ind. Reg. 3595 (Emphasis added).

However, the current version of Sales Tax Information Bulletin 2 states as follows:

Optional warranties and maintenance agreements that contain the right to have property supplied in the event it is needed are subject to sales tax if there is a reasonable expectation that tangible personal property will be provided. Any parts or tangible personal property supplied pursuant to this type of agreement are not subject to sales or use tax. Sales Tax Information Bulletin 2 (December 2006) (20100804 Ind. Reg. 045100497NRA)(Effective August 4, 2010) (Emphasis added).

The Department's guidance and interpretation on this issue relevant to the years for which Taxpayer was audited is found in Sales Tax Information Bulletin 2 (May 2002) which states that "Optional warranties and maintenance agreements that contain the right to have property supplied in the event it is needed are not subject to sales tax." Id. Therefore, Taxpayer was not required to collect sales tax on the warranties/maintenance agreements it sold its customers prior to August 4, 2010. However, it should be noted that during this same period, Taxpayer was required to self-assess use tax on any of the parts or supplies it provided its customers pursuant to those same agreements.

Taxpayer is on notice that as of August 4, 2010, Taxpayer is required to collect sales tax on the warranties/maintenance agreements it sells to its customers. The corollary remains true; under this regime, Taxpayer is not required to self-assess use tax on parts and supplies furnished pursuant to those later agreements.

The audit division is requested to review the original assessment of tax on the sale of warranties/maintenance agreements to its customers based on Sales Tax Information Bulletin 2 (May 2002) in effect during the audited years and to make whatever adjustment is appropriate.

FINDING

Taxpayer's protest of the imposition of sales tax is sustained in part and denied in part. Taxpayer's protest of Part A is respectfully denied, but Taxpayer's protest of Part B is sustained. The Department will recalculate Taxpayer's liability in a supplemental audit review.

II. Tax Administration – Negligence Penalty.

DISCUSSION

Taxpayer also protests the imposition of the negligence penalty.

Pursuant to IC § 6-8.1-10-2.1(a), the Department may assess a ten (10) percent negligence penalty if the taxpayer:

(1) fails to file a return for any of the listed taxes;

(2) fails to pay the full amount of tax shown on the person's return on or before the due date for the return or payment;

(3) incurs, upon examination by the department, a deficiency that is due to negligence;

(4) fails to timely remit any tax held in trust for the state; or

(5) is required to make a payment by electronic funds transfer (as defined in IC 4-8.1-2-7), overnight courier, or personal delivery and the payment is not received by the department by the due date in funds acceptable to the department.

45 IAC 15-11-2(b) further states:

"Negligence" on behalf of a taxpayer is defined as the failure to use such reasonable care, caution, or diligence as would be expected of an ordinary reasonable taxpayer. Negligence would result from a taxpayer's carelessness, thoughtlessness, disregard or inattention to duties placed upon the taxpayer by the Indiana Code or department regulations. Ignorance of the listed tax laws, rules and/or regulations is treated as negligence. Further, failure to read and follow instructions provided by the department is treated as negligence. Negligence shall be determined on a case by case basis according to the facts and circumstances of each taxpayer.

The Department may waive a negligence penalty as provided in 45 IAC 15-11-2(c), in part, as follows:

The department shall waive the negligence penalty imposed under IC 6-8.1-10-1 if the taxpayer affirmatively establishes that the failure to file a return, pay the full amount of tax due, timely remit tax held in trust, or pay a deficiency was due to reasonable cause and not due to negligence. In order to establish reasonable cause, the taxpayer must demonstrate that it exercised ordinary business care and prudence in carrying out or failing to carry out a duty giving rise to the penalty imposed under this section. Factors which may be considered in determining reasonable cause include, but are not limited to:

(1) the nature of the tax involved;

(2) judicial precedents set by Indiana courts;

(3) judicial precedents established in jurisdictions outside Indiana;

(4) published department instructions, information bulletins, letters of findings, rulings, letters of advice, etc.;

(5) previous audits or letters of findings concerning the issue and taxpayer involved in the penalty assessment.

Reasonable cause is a fact sensitive question and thus will be dealt with according to the particular facts and circumstances of each case.

The audit imposed the negligence penalty because Taxpayer shared its license with an individual and did not maintain adequate records and remit the sales tax on certain sales of vehicles. Upon reviewing Taxpayer's documentation, the Department is unable to agree that Taxpayer has met its burden and that its failure to pay tax or timely remit tax was due to reasonable cause and not due to negligence.

FINDING

Taxpayer's protest on the imposition of the negligence penalty is respectfully denied.

SUMMARY

For the reasons discussed above, on Issue I, Taxpayer's protest of the imposition of sales tax is sustained in part and denied in part. Taxpayer's protest of Part A is respectfully denied, but Taxpayer's protest of Part B is sustained.

On Issue II, Taxpayer's protest on the imposition of the negligence penalty is also respectfully denied.

The Department will recalculate Taxpayer's liability in a supplemental audit review.

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